

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3-PLR-166362-01

Date:

August 16, 2002

LEGEND

X =

Y =

Z =

Corporation =

Date 1 =

Date 2 =

Year 1 =

State =

Dear :

This letter responds to a letter written on your behalf, dated November 19, 2001, requesting a ruling regarding whether a life tenant who holds stock under a life estate created by a will qualifies as an eligible shareholder for S corporation purposes under § 1361 of the Internal Revenue Code.

FACTS

Corporation is a holding company which owns various subsidiaries. Y held stock in certain of these subsidiaries and that stock was exchanged for shares of stock in Corporation.

On Date 1, Y died in State, leaving a provision in his will that bequeathed first to his wife Z, then to X, a life estate in his property, including the stock of Corporation. The provision further provides that after the death of X, the property will be held for X's children until the children attain the age of 21, at which time the children will own the

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stock outright.

Under the provisions of the will, X, as a life tenant, has the right to income with no right to invade or make disposition of any part or portion of the principal. X is authorized to sell, transfer, or assign the property for purposes of administering it only, and for that purpose to invest or reinvest the property and any proceeds in investments deemed advisable provided the principal in value remains intact with a further provision that X shall not have the right to sell the stock in Corporation except in compliance with restrictions requiring an offer to sell to the Corporation and its profit sharing plan at a formula price. It is represented that the formula price is below the current market value. X has been the life tenant under the will since Z died in Year 1.

It is represented that under State law, a life tenant, with the power to sell or dispose of property devised to him or her for life with remainder to designated persons, is a trustee or quasi trustee and occupies a fiduciary relationship to the remaindermen. In the exercise of that power, the life tenant owes to the remaindermen the highest duty to act honorably and in good faith. A life tenant is a trustee in the sense that he cannot injure or dispose of property to the injury of the rights of the remaindermen, but differs from a pure trustee in that he may use property for his exclusive benefit and take all income and profits.

It is represented that if the arrangement created under the will with respect to the stock is treated as a trust, then the arrangement would satisfy the requirements of a qualified subchapter S trust (QSST) under § 1361 (d) (3).

Corporation intends to elect S corporation status as of Date 2. Accordingly, X requests a ruling as to whether an S corporation can have as a shareholder a life tenant who holds her interest in the stock under a life estate.

LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(3) provides that, for purposes of § 1361(d), a QSST means a

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trust (A) the terms of which require that (i) during the life of the current income beneficiary there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

CONCLUSION

Based on the facts represented and the information submitted, and provided that X makes a timely election to treat the arrangement created under the will with respect to the stock as a QSST, we conclude that the QSST may be a permitted shareholder of an S corporation. This ruling is based upon the information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provisions of the Code. Specifically, we express or imply no opinion on whether Corporation is otherwise eligible to be an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Christine Ellison
Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes.

cc: